COMMONWEALTH OF MASSACHUSETTS DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Telecommunications) and Energy on its own Motion into the Provision
of Default Service
D.T.E. 02-40

SUPPLEMENTAL COMMENTS OF THE DIVISION OF ENERGY RESOURCES

On August 9, 2002 the Massachusetts Division of Energy Resources ("DOER") filed Initial Comments responding to notice by the Massachusetts Department of Telecommunications and Energy ("DTE" or "Department") seeking comments in regard to its effort to ensure that Default Service is provided in a manner that is compatible with the development of an efficient competitive market and that the benefits of a competitive market are available to all Massachusetts consumers at the end of the Standard Offer period. In its comments, the DOER proposed several practical modifications to the existing manner that Default Service is procured and priced that are designed to both make Default Service more compatible with the development of an efficient competitive market and to make it an appropriate successor to Standard Offer Service. Many other parties filed comments in response to the Department's notice. The DOER has reviewed those comments and, as is explained below, provides these Supplemental Comments for the sole purpose of responding to those comments of other parties that raise issues bearing directly on the modifications proposed by the DOER.

A. Overview

Consistent with its Initial Comments, these Reply Comments by the DOER are limited to issues that have been raised concerning actions that the DTE could implement now (i.e., those not requiring legislative action or the resolution of significant contested issues of law or fact) to ensure that Default Service is provided in a manner that is compatible with the development of an efficient competitive retail market. This effort to focus the debate on Default Service reforms that can and should be implemented now to prepare for the end of the standard offer period should not, however, be interpreted to suggest that DOER does not share concerns underlying other parties' support for consideration of more fundamental modifications to Default Service and to the existing "retail" role of distribution companies. In particular, the DOER supports the view of those commenters who urged the Department to initiate an unbundling proceeding to examine comprehensively the range of services presently provided by distribution companies, to differentiate natural monopoly from other services provided by distribution companies, and to establish appropriate rates for such services (regardless of whether those services are to be opened to competition)¹. In addition, the DOER also supports the view that the Department should, ultimately, consider "privatizing" the provision of default service as well as consider facilitating competitive suppliers assuming responsibility for the entire retail customer interface (as is now the case, for example, in the United Kingdom). Cf. Initial Comments of Cape Light

In this regard, the TXU proposal that the Department establish "billing services" rates to apply to distribution companies rendering single bills on behalf of competitive suppliers suggests an avenue that should be explored in the very near future. The Department has recognized that "the development of a healthy competitive generation market" would be assisted by a billing option under which customers received a single bill from suppliers and the TXU proposal provides that advantage. Department of Telecommunications and Energy, Report to the General Court Pursuant to Section 312 of the Electric Restructuring Act, Chapter 164 of the Acts of 1997 On Metering, Billing and Information Services (December 29, 2000). Importantly, it does so in a way that assures continued customer convenience and maintains distribution company billing responsibilities/capabilities. See Initial Comments of TXU, pp. 29-31. See also: Initial Comments of PG&E National Energy Group, p. 9; Initial Comments of Competitive Retail Suppliers, pp. 5, 14 n. 4. Moreover, distribution companies would continue to "create and send the bills to retail customers" and the proposal does not require that billing be open to competition.

Compact, pp. 3; Initial Comments of TXU, pp. 32-36; Initial Comments of Massachusetts

Electric Company, pp. 19-20; Initial Comments of PG&E National Energy Group, p. 5, 9. Such reforms will necessarily require additional time to formulate and consider, but are consistent with the Restructuring Act which clearly contemplated and was intended to facilitate retail competition:

ratepayers and the commonwealth will be best served by moving from (i) the regulatory framework extant on July 1, 1997, in which retail electricity service is provided principally by public utility corporations obligated to provide ultimate consumers in exclusive service territories with reliable electric service at regulated rates, to (ii) a framework under which competitive producers will supply electric power and customers will gain the right to choose their electric power supplier.

St.1997, c. 164, § 1(c).

At this time, however, the need for action to prepare for the imminent end of the standard offer period demands the identification and timely adoption of practical Default Service reforms that advance that legislative objective as well as respond to the need for Default Service to evolve into a successor to the Standard Offer. These necessary immediate reforms should not be considered to represent the final transition of Default Service. Their adoption should not preclude future modifications to Default Service or to the existing "retail" role of distribution companies.² Further steps beyond those adopted in this proceeding will be necessary to put into place the neutral competitive environment in which a robust retail mass market could develop and achieve the Department's broad objective to "ensure that the benefits of a competitive market are available to all Massachusetts consumers at the end of the standard offer..." Indeed,

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² Among the other recommendations made in comments filed by other parties were those suggesting modifications be adopted to better encourage/facilitate the development of renewable resources. *See Initial Comments of MA Technology Collaborative*, pp. 11-12; *Initial Comments of CLF et al.*, pp. 11-12. The DOER believes that these suggestions for "opt in" products would properly be considered later as part of subsequent modifications to Default Service, perhaps in connection with a "ballot" type approach such as that advocated by the PG&E National Energy Group.

while the proposal advanced by the DOER in its Initial Comments could serve as a permanent pricing and procurement protocol for Default Service in the event that a robust competitive retail market for small customers does not develop (an outcome inconsistent with the experience in the United Kingdom and not considered likely by the DOER), it was formulated cognizant of the potential need for, and therefore is intended to be consistent with, more fundamental modifications of Default Service and of the existing "retail" role of distribution companies. *Initial Comments of Division of Energy Resources*, p. 15, n. 12.

These supplemental comments describe the extent that the proposal made in the DOER's Initial Comments is consistent with and advances objectives set forth in many of the Initial Comments filed in this proceeding by other parties. They also address three areas in which there appear to be conflicts between the DOER proposal and positions advanced in other parties' Initial Comments:

- ?? Whether it is appropriate to modify Default Service through the use of a surcharge/ credit mechanism to reflect certain uncontested costs of providing that service;
- ?? Whether a requirement that Default Service power suppliers answer distribution company customer questions concerning power supplies should be considered a change in electric service providers for purposes of G.L. c. 164, § 1F(8);
- ?? Whether the adoption of a staggered procurement process based on two year partial requirements contracts will impose an unnecessary burden on the cost of Default Service power supplies.

B. The DOER Proposal Meets The Objectives Expressed In Most Of The Comments

With some limited exceptions addressed in subsequent sections of these supplemental comments, the modifications to the existing manner in which Default Service is procured and priced that were recommended by the DOER in its Initial Comments address and, in most instances, meet the broad concerns and objectives expressed in the comments filed by other parties. As noted above, several parties proposed more fundamental changes to the current

market structure than the Default Service reforms recommended by the DOER and some proposed no change at all,³ but the DOER proposals are, in most material respects, fully consistent with and are largely supported by those comments that address modifications which can be readily implemented in the near term. *Initial Comment Massachusetts Electric Company*, p. 6-7 ("The Department should move forward with either of the alterative approaches"); *Initial Comments of NStar Electric*, p.10 ("the Department should consider whether to allow quarterly or "staggered" procurement schedules."); *Initial Comments of the Attorney* General, p. 6 ("Default Service for small customers should be procured and priced over a longer term..."); *Initial Comments of MassCAP*, p. 2 ("A rolling average portfolio is an appropriate remedy.").

There was a broad consensus that large and small customers have different competitive opportunities as well as different needs to be satisfied by Default Service and, therefore, that any modifications to the existing approach to Default Service should reflect these differences. See: Initial Comments of Competitive Retail Suppliers, pp. 5-6, 12-13; Initial Comments of National Energy Marketers Association, p. 4; Initial Comments of NStar Electric, pp. 7, 11-12; Initial Comments of The Energy Consortium, p. 1; Initial Comments of TransCanada, p. 1; Initial Comments of Western Massachusetts Industrial Consumers Group, p. 5; Initial Comments of the Office of the Attorney General, p. 6. The modifications proposed by the DOER are consistent with and advance the goals advanced by those parties. See Initial Comments of the DOER, pp. 17-24.

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³ Initial Comments of Western Massachusetts Electric Company, p. 5; Initial Comments of Dominion Retail, pp. 3-4. In should be noted that the need for the only near term change recommended by Dominion, the elimination of the imposition of reconciling adjustments for default service customers that migrate while on the uniform price option, is eliminated if the Department adopts the DOER's recommendation to eliminate the option of a fixed price.

⁴ The Competitive Retail Suppliers proposed that customers be divided into three groups and proposed specific demarcations between those groups. *Initial Comments of Competitive Retail* Suppliers, pp. 12-13.

While there are clear differences in the approaches recommended to achieve increased price stability for small customer on default service, ⁵ there was widespread support for that objective. The recommendation by the DOER for the use of medium term power supply contracts and a staggered procurement process achieves results that are largely consistent with those to be expected following other means suggested in other parties' comments to achieve price stability. *See e.g. Initial Comments of Constellation Power Source*, p. 2 (price fixed for up to 18 months); *Initial Comments of Competitive Retail Suppliers*, p. 13 (price fixed for 2 years); *Initial Comments of PG&E National Energy Group*, p. 7 (price fixed for 3 years).

Similarly, while there were differences among the commenting parties over the extent of the "costs" that should be reflected in the price of Default Service and the manner in which the necessary modification to Default Service pricing should be implemented, 6 no party disputed the need for the price of Default Service to "cover the avoidable costs" of providing that service. Finally, the DOER proposal to modify the provision of Default Service to require that Default Service power suppliers provide some "retail service" advances the objective of those

⁵ In contrast to the staggered portfolio approach recommended by the DOER and supported by others (*Initial Comments of Massachusetts Electric Company, Initial Comments of MASSCAP et al; Initial Comments of NStar Electric*) other commenters proposed modifications to Default Service that result in smaller customers having prices that remained fixed for relatively long periods of time. *Initial Comments of PG&E National Energy Group* (price fixed for 3 years); *Initial Comments of Competitive Retail Suppliers*, p. 13 (price fixed for 2 years).

⁶ There appears to be broad agreement that an appropriate share of a distribution company's uncollectibles expenses and procurement costs as well as locational marginal price (*i.e.* "congestion") costs and RPS compliance costs (whether incurred by distribution companies themselves or by default service suppliers) should be included in the price. The extent of agreement with regard to other "costs," such as EBIT and the default service reconciliation adjustment is far from clear. *Initial Comments of Bay State Consultants*, pp. 3-4; *Initial Comments of Competitive Retail Suppliers*, pp. 6-8. Consistent with its recommendation that the Department adopt an interim surcharge and credit mechanism to provide timely reflection of costs in the price of Default Service, the DOER suggests that the Department begin the process of reforming the price of Default Service by applying the surcharge approach to the obvious costs, reserving the resolution of other cost issues until a subsequent base rate proceeding.

commenters who urged the Department to reduce the role of distribution companies in the provision of Default Service.⁷

C. Eliminating The Default Service Rate Subsidy Need Not Await A Base Rate Case

In its initial comments, the DOER urged the Department to resume the unbundling of avoidable generation related costs by requiring distribution companies to institute a surcharge mechanism to include within the price of Default Service the associated uncollectibles and administrative expenses. While the inclusion of such costs within the price of Default Service was supported by every commenter that addressed this question, *see e.g. Initial Comments of the Attorney General*, p. 6; *Initial Comments of NStar Electric*, p. 9; *Initial Comments of Western Massachusetts Electric Company*, p. 2-3, language in some of those comments could be interpreted to suggest that such a change to the price of Default Service must be proceeded by a "base rate proceeding." For the reasons set forth below, the DOER submits that this suggestion is misplaced and that it flies in the face of the Department's practical approach to ratemaking.

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While there was some opposition to a requirement that suppliers of Default Service be licensed by the Department on the grounds that it could result in smaller, less secure suppliers, see Initial Comments of TransCanada, p. 1; Initial Comments of PG&E National Energy Group, p. 6; Initial Comments of Duke Energy Trading and Marketing, p. 1-2, 5, this opposition overlooks the fact that the proposal would enable the Department to provide increased protections for consumers and, DOER has already indicated that its proposal does not contemplate any lessening of consumer protections.

⁸ The "Joint Statement of Guiding Principles ..." endorsed by the Attorney General, NStar Electric, Massachusetts Community Action Program Directors Association, Inc. and Massachusetts Energy Directors Association contains the following Default Service design "recommendation":

The price of Default Service should include only those costs incurred to provide the service. These costs may include items such as costs of procuring energy, provided that an appropriate relationship is maintained between base rates and default service rates.

The Attorney General's recitation of that recommendation appends the following text as a footnote: "Consistent with the Department's decision in D.T.E. 99-60-A, 'identification and calculation of the administrative costs incurred by a distribution company in providing Default Service would appropriately be done in a base rate proceeding.' D.T.E. 99-60-A, p. 10."

Initial Comments of the Attorney General, p. 6.

First, while the DOER has acknowledged that a base rate proceeding is "the most comprehensive mechanism to eliminate cross-subsidies...," there is a very compelling public interest in a timely elimination of the existing Default Service price subsidy. As the Department has recognized, "the development of robust competitive retail markets" requires that "default service prices must take into account the full costs of providing the service..." Default Service, D.T.E. 96-60-A, p. 10 (May 10, 2000). In the absence of any basis to conclude that the pursuit of the base rate approach could produce a timely solution to the problem of the existing Default Service subsidy, the DOER submits that the public interest requires the application of a more practical approach such as the proposed surcharge/credit mechanism. A base rate case is not required for every rate change and there is ample precedent for the adoption of temporary adjustments between rate cases. Trustees of Clark University v. Department of Public Utilities, 372 Mass. 331, 336, 361 N.E.2d 1285, 1288 (1977)(temporary rate adjustment was warranted where "question of rate structure ... better dealt with in a full rate proceeding ..."); Monsanto v. Department of Public Utilities, 379 Mass. 317, 320, 397 N.E. 2d 1110, 1111 (1979)("cost need not be the sole criterion").

Moreover, the proposed surcharge/credit mechanism is consistent with the Department's current treatment of under- and over-recoveries of Default Service costs. Although the balance of any such amounts is attributable to costs and revenues incurred/collected in the provision of Default Service, those balances are collected from/returned to all distribution customers. *Default Service*, D.T.E. 96-60-C, pp. 10-13 (October 6, 2000). Given that the magnitude of the surcharge in question is well within the range of the level of recent "Default Service

⁹ It should be emphasized that the surcharge/credit mechanism proposed in the Initial Comments of the DOER would not result in any windfall for distribution companies and it would not result in any undue cost shifting if implemented on a customer class specific basis.

Adjustments" included in distribution bills, ¹⁰ the DOER submits that there is no rational or equitable grounds on which to argue that a base rate case is a necessary precondition to an adjustment to the price of Default Service to eliminate an existing anti-competitive cross-subsidy.

D. "Affirmative Choice" Is Not Required By The Restructuring Act For The Assignment Of Certain "Retail" Functions To Default Service Suppliers

In its initial comments, the DOER urged the Department to modify the existing structure of Default Service to reorient the focus of mass-market consumers regarding their power needs from their distribution company to the competitive market. In particular, the DOER recommended that the Department require distribution companies to:

- ?? inform their Default Service customers of the identity of the entity(ies) providing their power supplies;
- ?? "designate" each of their Default Service power suppliers to serve as the "Power Supply Representative" for a portion of the distribution company's default customers commensurate with the supplier's portion of the Default Service load;
- ?? require their Default Service power suppliers to operate a toll free telephone facility to respond to inquiries regarding Default Service from those customers for which it has been designated as the "Power Supply Representative" and to include that number and appropriate instructions on those customers' monthly bills; and
- ?? require their Default Service power suppliers to be licensed by the Department under G.L. c. 164, § 1F.

While no commenter expressed opposition to the particulars of these recommendations (most of which had been described previously during the course of the July 23 public hearing in this proceeding as well as during the June 21 "Electric Restructuring Roundtable" session) and many

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The "Default Service Adjustment" charge for all Massachusetts Electric Company distribution customers was 0.198¢/kwh in 2001 and is 0.83¢/kwh now; for Boston Edison Company, the 2001 charge was 0.363¢/kwh but there is no charge at this time. *See* Massachusetts Electric Company, D.T.E. 00-109 (December 3, 2000 Request for Comments) *Boston Edison Company*, D.T.E. 00-82 November 2, 2000 filing letter). These charges would have been considerably larger had they been limited to Default Service customers.

commenters proposed the assignment of even greater responsibilities to Default Service power suppliers, the DOER is constrained to explain why its recommendations should not be deemed to fall within those "virtual assignments" that could somehow be determined to offend the "affirmative choice" requirements of the Restructuring Act. In particular, the DOER submits that the recommended assignment to Default Service suppliers of the task of responding to a limited range of customer inquiries should not be construed to as a change in a customer's provider of electric service but should, instead, be considered a task assignment that is in many ways substantially less substantial than but, at a fundamental level, no different in customer impact than the allocation of customer interface responsibilities between distribution companies and conservation service vendors.

The disclosure of the identity of the actual suppliers of the power delivered to Default Service customers as well as the recommended assignment to Default Service suppliers of responsibility for responses to a limited category of customer inquiries does not constitute a change in electric service from the distribution company. Carrying out a distribution company's responsibility to respond to power supply questions from particular customers is simply not the provision of "electricity service." Under the DOER proposal, there would be no contractual relationship between Default Service suppliers and individual distribution company Default Service customers and, thus, there simply would be no change in electricity service provider for which a customer could provide the evidence of consent required under G.L. c. 164, § 1F(8).

In contrast to proposals made by other parties, the DOER recommendation does not involve customers being "enrolled" en masse as the electric service customer load served by

¹¹ The *Initial Comment of the Attorney General* include assertions that the Department should not allow any "assignment" of customers without their prior consent and that this prohibition should apply even in the event of a "virtual assignment." *Initial Comments of the Attorney General*, p. 4, n. 5 and accompanying test. It is not, however, clear what would constitute a "virtual" assignment" as that term is not defined by the Attorney General.

some third party, nor does it involve the "assignment" of individual customers to randomly selected participating third party suppliers in the event that those customers do not select a competitive supplier. Rather, the DOER proposal would involve disclosure of certain information to consumers and requiring that Default Service power suppliers respond to a limited range of customer information calls. This is no different than distribution companies contracting to have third parties to provide DSM or other enhanced customer services. While this proposal does advance the goal of better educating Default Service customers about the limited role of distribution companies in the provision of power supplies in the restructured marketplace, it does not call for the distribution company to delegate its responsibility to provide Default Service to its customers. Moreover, by including a requirement that Default Service suppliers be licensed by the Department under G.L. c. 164, § 1F(1), the proposal ensures that the Department will have adequate authority to protect against abuses that could lead to customer confusion.

E. The DOER Proposal Will Not Unnecessarily Burden Default Service Customers

While the comments of most other parties either supported or were consistent with the routine use of medium term default service supply contracts and a staggered procurement process to achieve price stability for smaller default service customers, a few comments argued against such modifications.¹³ Duke Energy complains that the use of longer term supply

¹² Compare: Initial Comments of Massachusetts Electric Company, pp. 13-14; Initial Comments of PG&E National Energy Group, pp. 8-9. This reference to proposals made in the cited comments should not be interpreted or otherwise construed to represent or otherwise manifest any determination by the DOER regarding their consistency with the requirements of G.L. c. 164, § 1F(8).

¹³ It should be noted that some parties expressed concern that any modifications not preclude strategic buying by distribution companies. *See Initial Comments of TransCanada*, p. 1. While the DOER acknowledges that there may be instances where variation from a prescribed procurement process may be appropriate, *see Initial Comments of* DOER, p. 18, n. 14, concerns for administrative efficiency as well as the experience with the "stranded costs" created under an earlier regulatory regime counsel against a process based upon hopes that distribution companies will "beat the market."

contracts would increase the cost of power and Fitchburg Gas & Electric Light Company and the Western Massachusetts Industrial Customers Group complain that it would reduce the responsiveness of Default Service to changing market conditions. *Initial Comments of Duke Energy Trading & Marketing, LLC*, p. 3; *Initial Comments of Fitchburg Gas & Electric Light Company*, pp. 5-6; *Initial Comments of Western Massachusetts Industrial Customers Group*, pp. 4-5. Western Massachusetts Electric Company and PG&E National Energy Group, on the other hand, complain that a staggered procurement process will result in smaller procurements that will reduce supplier interest and eliminate savings due to reduced economies of scale. *Initial Comments of Western Massachusetts Electric Company*, p. 4; *Initial Comments of PG&E National Energy Group*, p. 6. The DOER submits that all of these complaints are without merit.

The Department's goal in this proceeding is not to ensure that the Default Service power supplies are procured at the absolute lowest price and that such prices are always as closely aligned with current market conditions as possible (a goal that could readily be achieved by real time pricing). Rather, as explained by the Department, its goal here is to ensure that:

the manner in which Default Service is provided is compatible with the development of an efficient competitive market in Massachusetts...[and] that the benefits of a competitive market are available to all Massachusetts consumers at the end of the Standard Offer Service transition period.

Default Service, 02-40, p. 1 (June 21, 2002). For the reasons set forth in its Initial Comments, the DOER believes that use of two year contracts in a quarterly staggered procurement process will provide an appropriate balance between the sometimes competing goals of assuring compatibility with the development of an efficient competitive market, price stability, and market responsiveness. See Initial Comments of MASSCAP, p. 13 ("as low as possible consistent with costs"). While the DOER has acknowledged that this structure may need to be modified for the smaller distribution companies, there is no reason to believe that the resulting procurement

blocks for larger companies will result in any unreasonable increase in the cost of default service

supplies, particularly in light of the fact that those procurement blocks will likely be larger than

the existing total requirements procurements of the Commonwealth's smaller distribution

companies.

F. Conclusion

The DOER commends the Department for undertaking this timely inquiry. For all of the

reasons set forth here as well as in its Initial Comments, the DOER urges the Department to

adoption the proposal it has made as to how to best modify Default Service to ensure that it is

provided in a manner that is compatible with the development of an efficient competitive market

in Massachusetts and the provision of competitive options to all customers.

Respectfully submitted,

Commonwealth of Massachusetts

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Dated: September 9, 2002

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